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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies.))))))	Rulemaking 06-04-009 (Filed April 13, 2006)

ENERGY RESOURCES CONSERVATION
AND DEVELOPMENT COMMISSION
OF THE STATE OF CALIFORNIA

In the Matter of: AB 32 Implementation: Greenhouse Gases)))))))	Docket 07-OIIP-01

OPENING COMMENTS OF THE LOS ANGELES DEPARTMENT OF WATER AND POWER ON THE PROPOSED DECISION OF PRESIDENT PEEVEY: INTERIM OPINION ON GREENHOUSE GAS REGULATORY STRATEGIES

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OPENING COMMENTS OF THE LOS ANGELES DEPARTMENT OF WATER AND POWER ON THE PROPOSED DECISION OF PRESIDENT PEEVEY: INTERIM OPINION ON GREENHOUSE GAS REGULATORY STRATEGIES

In accordance with Rule 14 of the Rules of Practice and Procedure of the Public Utilities Commission ("CPUC" or "Commission") of the State of California, the Los Angeles Department of Water and Power ("LADWP") hereby files the following Opening Comments submitted in response to the "Proposed Decision of President Peevey: Interim Opinion on Greenhouse Gas Regulatory Strategies," filed February 8, 2008, in CPUC Rulemaking R.06-04-009 ("Rulemaking") and California Energy Commission (CEC) Docket # 07-OIIP-1.

I. <u>INTRODUCTION</u>

The LADWP remains committed to partnering with the State to achieve the goals of AB 32 to reach 1990 GHG emission levels by 2020. We believe that the best approach to fulfilling this commitment is through quantifiable direct emission reductions. We support the use of the Renewable Portfolio Standard (RPS) and Energy Efficiency (EE) as mechanisms for the electricity sector to meet its AB 32 goals. However, the CPUC and CEC, through this Proposed Decision (PD), have failed to develop an effective framework for reducing emissions from <u>all</u> participants in the California energy sector (electricity and natural gas), and have failed to address concerns raised in this proceeding about the shortcomings of the first deliverer concept, especially as it affects publicly owned utilities (POUs). Instead, they have chosen a point of regulation that is tailored for investor-owned utilities, that is legally infirm, and fails to demonstrate how it will effectively meet the legal mandates of AB 32. In summary, the LADWP makes the following points in these opening comments:

- The LADWP remains committed to AB 32 and achieving meaningful GHG emission reductions.
- The Joint Commissions should reject the PD recommendation to assign the compliance obligation to the first deliverer and to distribute allowances by auction.
- The PD must be revised to provide an alternative compliance option to a cap-and-trade scheme than allows for direct emission reductions.
- The first deliverer/auction approach incorrectly prioritizes financial market structures over direct emission reductions.
- The PD fails to adequately accommodate public power.
- The PD reflects a bias in favor of IOUs.
- Any wealth transfer under first deliverer and related auction cannot be tolerated.
- First deliverer is legally infirm.

This proceeding has improperly used AB 32 as justification to focus on markets, with discussion dominated by corporate interests, instead of focusing on direct emission reduction mechanisms. We strongly support development of a regional or national program, and believe a California-only cap-and-trade program for the electricity sector combined with first seller and full auctions is the wrong public policy and will ultimately fail. The many risks posed by California's acting in isolation and proposing a never-before tested unconventional market scheme will be borne solely by the electric ratepayers of California. The Legislature directed the Air Resources Board (ARB) to design emission reduction measures in a manner that:

- Minimizes costs and maximizes benefits for California's economy;
- Improves and modernizes California's energy infrastructure;
- Maintains electric system reliability;
- Maximizes additional environmental and economic co-benefits for California; and
- Complements the State's efforts to improve air quality.

Regrettably, the strategy that the CPUC and CEC are recommending fails to maximize GHG emission reductions and uses AB 32 as a tool to enable the development of a cap-and-trade program that creates financial winners and losers at the expense of real emission reductions. The PD itself acknowledges, "**additional reductions due to a cap-and-trade system from the electricity sector will likely be small [in the short term]**."[1] The LADWP is not alone in raising concerns about how a cap-and-trade program is being developed in California, there is a ground swelling of opposition. Our sister utilities have also expressed concerns via the California Municipal Utilities Association and the Southern California Public Power Authority regarding the point of regulation and impacts that an allowance auction may have on our local communities. The environmental justice community has also declared its opposition to the use of carbon trading and offsets because of their failure to achieve actual emissions reductions, the irreconcilable problems with trading experiments and offset use, and because of their inability to cause a timely fundamental change in the way we make and use energy.[2] Labor interests are also expressing significant concerns.

Additionally, this forum has also become an opportunity for some interests to impose a "true up" of rates between investor owned utilities (IOUs) and POUs, erode the stability of the POU business model to remain vertically integrated and fully resourced[3], and risk another energy crisis by ignoring potential electric grid instability and customer rate shock.

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[1] Proposed Decision, at 33.
[2] The California Environmental Justice Movement's Declaration Against Use of Carbon Trading Schemes to Address Climate Change, http://www.ejmatters.org/index.html
[3] Proposed Decision, at 64-65.

II. <u>LADWP'S COMMITMENT TO AB 32 AND ACHIEVING MEANINGFUL GHG EMISSION REDUCTIONS</u>

The City of Los Angeles Department of Water and Power (LADWP) is the Nation's largest municipally-owned utility. Established in 1916, LADWP serves almost 4 million residents and has a maximum generating capacity of 7,400 Megawatts of electricity. LADWP has been a Charter Member of the California Climate Action Registry since September 2002, and has reported and certified its 2000 through 2006 annual entity-wide greenhouse gas emissions inventories with the Registry, more years than of any other California electric utility. Since 1998, with the divestiture of Colstrip and Deseret coal contracts, the LADWP began taking steps to move away from dependence on coal resources; and with the passage of SB 1368 and AB 32, we calibrated our efforts to ensure LADWP funding strategies are in place to reduce our GHG emissions in advance of 2012. In 2007, the City of Los Angeles adopted its "Green LA Plan", an aggressive plan for reducing the City's overall greenhouse gas (GHG) emission levels to 35% below 1990 levels by 2030, of which the LADWP plays a lead role through our RPS and EE programs.

Accordingly, LADWP has established an aggressive goal of developing and owning new renewable generation to meet our 20% by 2010 and 35% by 2020 RPS mandates. LADWP has been already begun working aggressively to meet its goals. Since 2005, LADWP has nearly tripled its portfolio of renewable energy. LADWP increased its share of renewables from less than 3% in 2005 to approximately 8% <u>delivered</u> today, and has more energy projects currently under development to meet the 20% by 2010 mandate. LADWP has also significantly increased funding for energy and water efficiency programs, green fleet vehicles, and upgrades to existing natural gas generation facilities as a significant component of reducing its GHG emissions, which provides additional community and environmental co-benefits. LADWP established a LEED Building program to provide incentives for buildings that meet higher environmental standards, complementing the City of Los Angeles' recently adopted Green Building Ordinance.

III. <u>THE JOINT COMMISIONS SHOULD REJECT THE PD RECOMMENDATION TO ASSIGN THE COMPLIANCE OBLIGATION TO THE FIRST DELIVERER AND TO DISTRIBUTE ALLOWANCES BY AUCTION</u>

The recommendation that the point of regulation under AB 32 be the "deliverer" differs only in name from the "first seller" proposal that has been the subject of much negative attention in these proceedings. For the reasons stated in its prior submissions and testimony, LADWP opposes the First Deliverer approach and supports a retail load-based point of regulation.[4] LADWP also continues to oppose the auctioning of allowances, as is recommended in the PD. By far the most important issue with auctions is the diversion of billions of dollars away from GHG emission reduction initiatives and into a cap-and-trade "pot", thus frustrating the very purpose of AB 32.

IV. THE PD MUST BE REVISED TO PROVIDE AN ALTERNATIVE COMPLIANCE OPTION TO A CAP-AND-TRADE THAT ALLOWS FOR DIRECT EMISSION REDUCTIONS

Should the CPUC and CEC decide to adopt the First Deliverer point of regulation, then the PD must be modified to include an alternative that allows an option to directly reduce emissions. As we understand it, a cap-and-trade program that is combined with 1) First Deliverer point of regulation and 2) full auction would only lend itself to sector-specific emissions caps (i.e. a collective cap over the electricity sector). Under a load-based approach, entity-specific emissions caps (i.e. a declining annual caps over a specific regulated entity) could be imposed on each California retail provider covering the emissions associated with serving their native load. Under first deliverer, however, it is unclear whether and how entity-specific emissions caps could still be applied equitably to the entire electricity sector that now includes marketers that buy and sell power, but that may not meet the traditional definition of "source" as a physical generator/facility with stack emissions. Such marketers might include financial institutions that participate in the wholesale electricity market. The only means for a marketer to comply with AB 32 would be to purchase allowances at auction and imbed that cost into the cost of wholesale electricity deliveries to the California grid. If there are no longer any entity-specific declining caps or emission reduction goals, and only a sector-wide declining cap remains in place under first deliverer, then it appears impossible to avoid a full auction in order to provide all entities with equal access to emission allowances.

Specifically at the time that the ARB's Scoping Plan is complete and the details of a multi-sector cap-and-trade program are fully known, ***retail providers that are vertically integrated and therefore also the first deliverer must be given the option to choose between full participation in the AB 32 cap-and-trade program or a compliance mechanism that involves direct emission reductions for entity-specific declining emission caps***. With this alternative, entities' emissions would be capped for their portfolio of

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[4] See Opening Comments of the Los Angeles Department of Water and Power on the Administrative Law Judges' Ruling Requesting Comments and Legal Briefs on Market Advisory Committee Report, filed August 6, 2007. Joint En Banc Hearing of PUC and CEC on Point of Regulation in the Electricity Sector, August 21, 2007, testimony of LADWP on Allowance Allocations Panel.

electricity generation used to serve California native load and would be required to met AB 32 goals by 2020 and beyond. This alternative compliance plan would better meet the intent of AB 32 to minimize costs and maximize environmental benefits by providing regulatory certainty, imposing known entity-specific caps, preserving grid reliability, minimizing exposure to price volatility, directly supporting development of clean renewable resources in California, retaining ratepayer dollars for direct GHG investments in the local community, and maximizing local air quality and economic co-benefits.

V. THE FIRST DELIVERER/AUCTION APPROACH INCORRECTLY PRIORITIZES FINANCIAL MARKET STRUCTURES OVER DIRECT EMISSION REDUCTIONS

Throughout this proceeding, the LADWP has repeatedly stated its commitment to reduce its GHG emissions and to assist the State in achieving its AB 32 goals. The PD provides no accommodation for vertically integrated public utilities with a direct reduction strategy and instead subjects us all to the unknown risks of a limited California-only untested carbon market that is designed for CAISO participants. The LADWP agrees with the State that there are benefits to including a cap-and-trade program in the implementation of AB 32, but we are extremely concerned that the CPUC/CEC are designing an untested and convoluted cap-and-trade program that over compensates corporate-driven interests and penalizes the very entities that are taking immediate steps to deliver real and permanent early emission reductions. Any recommendations that emerge from the CPUC/CEC Joint Proceeding should reflect wide-ranging strategies that best accommodate various stakeholders and provide the flexibility necessary to coordinate with future regional or national programs. The CPUC/CEC have failed to accomplish this with the PD and we urge you, as you consider your next set of decisions, to better appreciate all sector participants and develop a recommendation that is more complete.

While the CPUC is a leader on many energy sector initiatives, like renewables and energy efficiency, it has not demonstrated success in recommending market structures for the electricity sector. The LADWP, along with other POUs, correctly elected not to participate in deregulation, but did not come out of the 2000-2001 energy crisis unscathed, having ultimately paid a colossal $44 million for RECLAIM NOx emission allowances in addition to unanticipated in-basin generation fuel costs during the period from July 2000 to January 2001 to serve non-LADWP load at the request of the State. Economists and market interests strongly advocated for untested financial re-engineering of the electricity sector through deregulation before the CPUC and California State Legislature, just as they are advocating for carbon markets and full auction of emission allowances in this Joint Proceeding. These parties have little vested interest in serving California customers, and therefore share no responsibility for protecting customers from rate spikes, maintaining grid reliability and keeping the lights on.

VI. THE PD FAILS TO ADEQUATELY ACCOMMODATE PUBLIC POWER

The CPUC is again exploring the possibility of restoring retail competition (i.e. deregulation) for the California electricity market in Proceeding R.07-05-025. POUs, including LADWP, remain vertically integrated and fully resourced, and do not rely on the wholesale electricity markets to meet our native load, and that proved prudent when LADWP and other POUs were asked to come to the aid of the State. Direct emission reductions complement this business model, yet the PD rejects this approach without reason, and instead opts for a program that will needlessly interfere with public power's efforts. The PD states:

> "Further erosion of the vertically-integrated portion of the industry and/or decreased reliance on long-term, unit-specific contracts would likely increase the amount of unspecified energy flowing through California's markets. The deliverer point of regulation can best accommodate such a development as it does not require source-to-sink tracking of all transactions." PD at 64-65.

The PD inappropriately justifies the First Deliverer on a market structure that runs contrary to the business model of POUs, and that is currently prohibited by State law (AB 1X) that suspended Direct Access, a component of deregulation. Additionally, greater reliance on an increased amount of unspecified energy in the market increases the risk that carbon-based power gets laundered through the market and assigned a lower emission rate than the actual source(s), thereby jeopardizing the environmental integrity of AB 32 to achieve real emission reductions.

VII. THE PD REFLECTS A BIAS IN FAVOR OF IOUS

A. Excluding the natural gas sector from cap-and-trade without imposing emission reduction goals is poor public policy

The PD adopts the position advocated by the IOUs (PG&E, So Cal Gas and SDG&E) that the natural gas sector be excluded from a cap-and-trade program. This exclusion runs contrary to the PD recommendation and the intent of the Legislature, under AB 32, that the ARB "design emission reduction measures, including limits on emissions of greenhouse gases applied to electricity and ***natural gas providers***…"[5] (emphasis added). It also contradicts the primary recommendation from CPUC's own staff to include that sector if a cap-and-trade regime is established for the California economy. This is a lost opportunity to achieve significant emission reductions, especially since the recommended programmatic strategies (i.e. end-user

[5] California Health and Safety Code, Section 38501(g).

energy efficiency) are not combined with enforceable utility-level declining emission caps to ensure effectiveness of those strategies. If direct emission reduction strategies are not available, the natural gas sector should be mandated to implement emission offset projects, such as natural gas fleet purchases, incentives and development of fueling infrastructure, in order to meet a declining cap for that sector. <u>In no way should the natural gas sector be allowed to avoid direct regulatory compliance costs through this exemption from the AB 32 emission reduction program and then be allowed to use ratepayer dollars for emission offset projects and/or financially profit from developing those projects and selling the corresponding emission offsets to other regulated entities.</u>

The ARB's adopted 1990 inventory attributes 110MMT to the electricity sector, or 25% of the statewide inventory, while natural gas sector emissions from the combustion by end users (excluding electric generation) and transmission, distribution, and storage are approximately 69 MMTCO2E, or 16% of statewide GHG emissions.[6] The fugitive methane emissions associated with transmission are 21 times more potent per unit of mass than CO2 on average over a long time frame.[7] Despite this, the PD proffers a number of reasons for exclusion of the natural gas sector that do not hold true.

B. <u>Total carbon emissions are what count and not carbon intensities</u>

When it comes to total GHG emissions from the electricity sector, SCE and PG&E are the 1st and 2nd highest emitters of absolute GHG emissions (MMT) in the California electricity sector[8] Total emissions from the energy sectors increase significantly when non-electric generation natural gas operations are included.[9] In terms of carbon intensity, natural gas is a fossil fuel that also has carbon emissions that should not be summarily dismissed. Despite the fact that the natural gas sector accounts for 16% of the State's GHG overall emissions, some entities have successfully lobbied to shift away their compliance burden, thereby leaving other regulated entities to make up the shortfall.

Regarding coal resources, the LADWP currently has coal interests totaling 1,551 MW in Intermountain Generating Station and Navajo Generating Station combined. These are not the only coal-fired plants serving California load. Other IOU interests not only own 750 MW of coal-

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[6] California Public Utilities Commission, Preliminary Staff Recommendations for Treatment of Natural Gas Sector Greenhouse Gas Emissions, July 12, 2007, at 2. Note: This CPUC report references outdated CEC GHG inventory data. Using the ARB adopted 1990 inventory, natural gas accounts for 16% of the statewide inventory, not 14% as stated in the staff report.

[7] *Ibid, at 8.*

[8] 2005 Total Generation Portfolio CO2 Emissions as reported the California Climate Action Registry: SCE was 23,718,199 MMT; PG&E was 17,196,414 MMT; LADWP was 16,734,820 MMT.

[9] CPUC Staff Recommendations, at 5.

fired generation that is imported to California, but have other domestic holdings in excess of 7,500 MW, over five times the amount of coal assets owned by the LADWP. While the LADWP is taking efforts to move away from coal-fired resources, the CPUC appears to have no intention to compel the IOUs to diversify away from coal. Indeed, the CPUC is considering actions to spend $46 million of California ratepayer dollars to fund research that may ultimately preserve IOU coal interests located out-of-state."[10] We do not believe that this technology will be commercially available in the same time frame as AB 32 compliance and the CPUC's own economic modeling contractor, E3, reflects the same position in their model that carbon capture and sequestration is not an available emission reduction strategy in 2020.[11] All California entities should commit to real and permanent GHG emission reductions.

C. <u>AB 32 is not a tool to "true up" rates between IOUs and POUs</u>

The CPUC and CEC have allowed the Joint Proceeding to be used as a forum to suggest that southern California POUs have historically enjoyed lower retail rates than IOUs as a result of having access to coal-fired resources, and IOUs investment in clean generation, with the implication that the purchase of emission allowances through auction will help to "true up" rates.[12] In fact, IOU rates are higher because they fully supported and participated in California's unfortunate experiment with deregulation (which the CPUC now wishes to bring back) that forced them to rely to a greater extent on the wholesale electricity market. LADWP and other POUs did not. IOU rates continue to include 1) costs associated with the Department of Water Resources bond charge to cover costs for purchasing power starting with California's 2000-2001 energy crisis and continuing today, 2) the trust transfer amount that covers the principal and interest on 10-year bonds to fund rate reductions during the first four years of deregulation, and 3) the ongoing competition transition charge to reimburse IOUs for the cost of energy contracts and generation investments that were not fully recovered when sold as part of deregulation.

A "true up" of rates conceivably could occur under any allowance distribution method. Choosing financial winners and losers to resolve past competitive issues is inappropriate and should never be a factor in these proceedings. When an allowance distribution method ignores the emissions starting point of a regulated entity, and distributes allowances or auction revenues in a manner that over-compensates some parties in relation to their compliance burden,

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[10] CPUC A.07-05-020, Proposed Decision of ALJ Yip-Kikugawa, Southern California Edison, at 5.
[11] E3 Modeling for CPUC R.06-04-009.

[12] CEC/CPUC Workshop on Greenhouse Gas Emission Allocation for the Electricity Sector, November 5, 2007, Reporter's transcripts, PG&E at 147-148, Burbank at 132-140, SCPPA at 156-162, SDG&E at 170-171.

financial winners and losers are chosen. It is unacceptable for the CPUC and CEC to continue down the first deliverer path that results in the "true up" that is being advocated by certain stakeholder IOUs.

VIII. ANY WEALTH TRANSFER UNDER FIRST DELIVERER AND RELATED AUCTION CAN NOT BE TOLERATED

Auction of allowances is not contemplated or permitted by AB 32. If found to be legal, only a very small auction of allowances might be acceptable to account for new entrants. Their purported benefits are speculative at best. Because the auctions would needlessly divert resources from municipal programs, such as LADWP's, to procure and own new renewable generation, the auctions would violate the right of home rule that is guaranteed to charter cities and their municipal utilities by the California constitution. Auctioning simply drains funds from LADWP in a way that will hobble, if not cripple, the programs that LADWP has adopted, in the exercise of its powers as a charter city, to achieve direct GHG reductions.

LADWP cannot simply stand by and submit to a distorted implementation of the statute that was not contemplated by the Legislature and that mandates significant or full auctioning of allowances, with revenue recycled to other sector or out-of-sector participants and away from municipal activities to reduce GHG emissions.

IX. HOW AUCTIONING ALLOWANCES WOULD IMPACT LADWP

It is important for the Commissions and CARB to keep in mind how full auctioning of allowances would work. While we acknowledge that the PD leaves open what portion of the allowances would be auctioned and what would be done with the auction proceeds, it appears implicit in the proposed recommendations that a significant portion of the allowances would be auctioned[13] and that bidders in the auction may not receive back all that they pay in.[14]

Being vertically integrated is a core LADWP business policy. It permits LADWP and its ratepayers to maximize the economic benefits conferred by its superior credit rating, its access to lower cost tax exempt debt markets and the fact that LADWP is itself tax exempt and operates on a non-profit basis.

As previously stated, the Legislature left it to LADWP to decide whether it would choose to become part of the new state-wide system of direct access and ISO-controlled transmission

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[13] "Based on further analysis, we may recommend . . . that allowances should be distributed entirely by auctions, or alternatively using a mix of auctions and free allocations which may transition over time to a system of greater reliance on auctions. Proposed Decision, page 7.

[14] "An integral part of this auction recommendation is that at least a portion of the proceeds from the auctioning of allowances for the electricity sector should be used in ways that benefit electricity consumers in California." Proposed Decision, page 6. The other portion, whatever that may be, would apparently be used for other purposes.

or to continue to chart its own course as a vertically integrated utility. This deference by the Legislature was consistent with the requirements of the state Constitution (discussed below) and with historical practice. In the thirteen years that have passed since the legislature recognized LADWP's right to structure its system differently that the IOUs, LADWP's planning, including in the area of renewables, has only become more committed to remaining fully resourced. We submit it is at least inequitable for the Commissions and CARB to try to change that long established course now. We also suggest that some diversity in resource planning, including the way in which AB 32 is implemented, is a positive that the Commissions should encourage even if it were not mandated by the state Constitution, as we believe it is.

Because it is vertically integrated, LADWP would be the "deliverer" of virtually all the energy it provides at retail. As is well known, that energy is comparatively carbon intensive because of the two coal plants that are in LADWP's generation portfolio. These plants each were built during the 1970s, long before GHG emissions were recognized as a problem and at a time when natural gas was precluded as a fuel source, both by prudent procurement policy and (for a time) by federal statute.[15]

LADWP estimates that the carbon emissions from generation for which it is the "deliverer" will be 14 million metric tons in 2012. Thus, in a pure auction system, LADWP would be required to purchase allowances in the first year to cover those emissions. In each

[15] In 1978 Congress passed the Powerplant and Industrial Fuel Use Act (PIFUA) which was intended to encourage the use of coal for the generation of electricity. 42 U.S.C. § 8301. For many years, PIFUA prohibited use of natural gas or petroleum as the primary energy source in new major fuel-burning installations consisting of a boiler, unless an exemption applied, and it authorized the Secretary of Energy to prohibit nonboilers from using natural gas or petroleum. 42 U.S.C. § 8312 (repealed by Pub. L. 100–42, § 1(a)(1), May 21, 1987, 101 Stat. 310). Thus, when LADWP required a new source of electricity to serve the people of Los Angeles in the late 1970's and early 1980's, it had little choice but to invest in coal-fired generation. PIFUA, of course, is an independent source of federal preemption challenges to AB 32 insofar as it applies to investments that PIFUA encouraged. State law generally cannot punish what federal law required. *See, e.g., Farmers Union v. WDAY, Inc.,* 360 U.S. 525 (1959) (state cannot impose "liability for the very conduct the [federal] statute demands"); *Automobile Workers v. Johnson Controls, Inc.,* 499 U.S. 187, 209-10 (1991). Additionally, state law generally cannot substantially penalize acts that federal law specifically seeks to promote. *See, e.g., Xerox Corp. v. County of Harris,* 459 U.S. 145, 151 (1982) (federal law, specifically trying to encourage transshipments of freight by foregoing federal taxes, preempted state tax on same transshipments); *McGoldrick v. Gulf Oil Corp.,* 309 U.S. 414 (1940) (similar); *Nash v. Fla. Indust. Comm'n,* 389 U.S. 235, 240-41 (1967) (state law preempted from withdrawing state benefits based on act Congressional policy sought to leave uninhibited; state cannot "retard, impede, burden or in any manner control" federal law).

succeeding year, LADWP would be required to make similar purchases, although in gradually declining quantities.

Over the next five years before compliance begins in 2012, LADWP will be making aggressive investments in programs to directly reduce GHG emissions (RPS, EE). Rather than divert its funds to the purchase of allowances, the LADWP wishes to continue to dedicate its resources to the direct reduction of its emissions.

X. LEGAL ISSUES

As noted earlier, the auctioning of allowances raises legal issues that are specific to that aspect of the proposed implementation. In addition, with or without auctions, the proposed program suffers from other legal infirmities.

A. Auction Specific Issues

1. Home Rule

As has been noted previously, the reallocation of funds caused by the proposed auction structure would financially undermine LADWP's current and ongoing renewable procurement program. This would not happen in a direct emission reduction program.

As also noted previously, LADWP wants and intends to be part of the statewide effort under AB 32 to reduce GHG emissions. However, there is a legal and historical basis for accommodating LADWP as a municipal operation. As a department of the City of Los Angeles, which is a charter city, LADWP is entitled under the state Constitution to "make and enforce all ordinances and regulations in respect to municipal affairs."[16] The operational affairs of a charter city's municipally owned utility have long been recognized as "municipal affairs."[17]

The Constitution, of course, recognizes the State's right to regulate matters of "statewide concern,"[18] subject to federal preemption on matters within federal jurisdiction. But when the State does so, its actions must be "both (i) reasonably related to the resolution of that concern, and (ii) "narrowly tailored" to limit incursion into legitimate municipal interests."[19] The PD satisfies neither test.

A convoluted cap-and-trade system is not the ideal (or preferable) mechanism to achieve real greenhouse gas reductions. Even if it were, auctions are not the ideal way to implement a cap-and-trade system,[20] nor will they have any beneficial effect on the reduction of greenhouse gas emissions under a California-only program. <u>The Commissions recognize that</u>

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[16] California Constitution, Article 11, Section 5(a).
[17] See *Los Angeles Gas & Elec. Corp. v. Los Angeles*, 188 Cal. 307, 317-318 (1922).
[18] *See California Fed. Sav. & Loan Assn. v. City of Los Angeles*, 54 Cal. 3d 1, 7, 13 (1991).
[19] *Johnson v. Bradley*, 4 Cal. 4th 389, 404 (1992).
[20] *See* Cantor CO2e comments to the Market Advisory Committee, dated June 12, 2007.

their proposed cap-and-trade system will initially yield only a "small" part of those reductions, any impact beyond that is only speculative, and the proposed auctions are not a necessary part of the cap-and-trade system.[21]

A direct emission reduction program, with entity-specific declining caps would not undermine municipal programs and polices that LADWP and the City of Los Angeles have adopted.[22] Under these circumstances, the auction structure violates the home rule provisions of the California Constitution.

2. AB 32 Does Not Authorize Auctions And Would Violate Proposition 13 If It Did

As LADWP has noted in previous filings, AB 32 does not provide for the auctioning of allowances. If it did, it would violate Article XIIIA of the California Constitution, which provides that "any changes in State taxes enacted for the purpose of increasing revenues … must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the legislature …" AB 32 was not passed by such a vote.[23]

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[21] Proposed Decision, p. 33 and 83.

[22] "We make this recommendation [for auctioning] in order to promote liquidity in the emission allowance market, improve accuracy of emission allowance prices as a reflection of marginal emission reduction costs, improve investment incentives, avoid windfall profits at consumer expense and allow new market entrants easy access to allowances." Proposed Decision at p.6. These summary conclusions are the product of a two page analysis (at pp. 83-85 of the PD) that is plainly wrong, self-contradictory and shockingly short and superficial, given the severe environmental and economic consequences of the proposed auction system. Even if that were not the case, we submit it is not appropriate for the state to divert public funds (LADWP revenues) that are needed for an overriding public purpose (GHG reductions) to support a secondary, private for-profit market. That also violates the California Constitution. "The Legislature may not delegate to a private person or body power to . . . control, appropriate, supervise or interfere with . . . municipal . . . money, or property, or to levy taxes or assessments, or perform municipal functions." California Constitution, Article 11, Section 11(a).

LADWP's participation in the auctions is not necessary to "promote liquidity in the emissions allowance market." This purported justification for the auctions comes, not surprisingly, from one of the trader parties. "[D]istributing allowances for free can lead entities to forego selling their unneeded allowances, creating an illiquid situation early on as excess allowances sit stagnant without corresponding benefits to end-users." Opening Comments of Morgan Stanley Capital Markets Group on the ALJ's Ruling Requesting Comments and Noticing Workshop on Allowance Allocation Issues, p. 2. The simple answer to this concern is do not overallocate allowances to those parties, like LADWP, that should receive them through an administrative allocation.

The Proposed Decision itself contradicts the proposition that auctions are necessary to "improve accuracy of emission allowance prices as a reflection of marginal emission reduction costs." To the contrary, "regardless of initial emission allowance distribution methodology, . . . there would be active trading of emission allowances" (PD at p. 83) and "the power market would tend to reflect the value of allowances, regardless of whether allowances are distributed via auctions or free allocations." (PD at p. 84).

LADWP's participation is not needed to "improve investment incentives." Under LADWP's proposal, it will be committed to meet the emission reduction targets CARB sets. This is all the "investment incentive" a public entity requires. As noted earlier, LADWP's GREEN LA program will involve the expenditure of billions of dollars.

Finally, LADWP's participation also is not needed to "avoid windfall profits." As the Market Advisory Committee has recognized, this is not a concern with nonprofits such as LADWP. Mac Report, page 56.

[23] In this context, it is instructive to note the letter that Speaker Nunez, the author of AB 32, submitted to the Assembly Daily Journal on August 31, 2006 (page 7646), the day the Assembly voted on AB 32. In that letter

B. Other Legal Issues

1. Federal Power Act

We respectfully disagree with the conclusion that the deliverer approach does not regulate or impose a license requirement for wholesale transactions.[24] Virtually all deliverers will be wholesale sellers or buyers. To engage in those transactions, the deliverer will have to surrender a state-issued allowance or face a penalty. This amounts to regulation of the wholesale transaction. It is not legally justified by the fact that the regulation may be driven by environmental concerns. Federal jurisdiction over wholesale transactions is exclusive.[25]

2. Dormant Commerce Clause

The Proposed Decision concludes that "The deliverer point of regulation . . . does not regulate any commerce that occurs totally outside of California, and therefore does not regulate extraterritorially in violation of the Commerce Clause."[26] This may be erroneous. The reporting protocols that have been adopted by the Commissions and proposed by CARB attribute emissions associated with electricity generated outside the state to an in state deliverer that owns the generation, even when the electricity is sold out of state and never imported into the state.[27]

States generally "may not attach restrictions to exports or imports in order to control commerce in other States."[28] A deliverer/first seller approach arguably does just that because requiring allowances could be viewed as attaching a condition (the need for emission allowances) to importation (of power generated outside California) for the purpose of controlling commerce in other states (*e.g.,* controlling the method of generation and the amount of emission in the states).

Furthermore, if a state statute incidentally burdens interstate transactions such a statute will violate the Commerce Clause under what is knows as the *Pike* analysis, if the burdens it

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(available at http://www.assembly.ca.gov/clerk/billslegislature/srchframe.htm) Speaker Nunez states: "AB 32 authorizes the California Air Resources Board to adopt a schedule of fees for the direct cost of administering the … programs established pursuant to the bill's provisions. It is my intent that any funds provided by Health and Safety Code Section 38597 (the part of AB 32 that authorizes the schedule of fees) be used solely for the direct costs incurred in administering this division." Clearly, the intent of this letter was to bolster the argument that charges payable pursuant to the fee schedule fall within the "regulatory fee" exception to Proposition 13. See Sinclair Paint Co. v. State Board of Equalization, 15 Cal. 4th 866 (1997). Had the Speaker believed that AB 32 included other revenue generating provisions, such as an auction, he would have tried to craft his letter to cover those too.

[24] Proposed Decision, pages 71-72.

[25] *Fed. Power Comm'n v. S. Cal. Edison Co.,* 376 U.S. 205, 215-16 (1964); *Cal. Ex. Rel. Lockyer v. Dynegy,* 375 Fed.3d 831, 850-51 (2004).

[26] Proposed Decision, page 76.

[27] *See* proposed CARB Regulations, Section 9511(b)(3)(N) - (P); Joint Commissions Interim Opinion on Reporting and Verification of Greenhouse Gas Emissions in the Electricity Sector, pp. 17 - 23.

[28] *C & A Carbone, Inc. v. Clarkstown,* 511 U.S. 383, 393 (1994) (citing *Baldwin v. G. A. F. Seelig, Inc.,* 294 U.S. 511 (1935)); *Healy v. Beer Inst.,* 491 U.S. 324, 336 (1989).

imposes on local commerce are "clearly excessive in relation to the putative local benefits."[29] While the Proposed Decision concludes that "the local benefits to California of reducing GHG emissions, and therefore the impact of global warming, are most significant,"[30] the burden these benefits impose on local commerce is excessive. However, regardless of local benefits and the *Pike* analysis, the Commerce Clause does not allow a State to regulate conduct in another State.[31] In addition, the Proposed Decision fails to analyze the extent to which a convoluted, California-only, deregulation-based cap-and-trade scheme will affect global GHG emissions and thus ameliorate the impact of global warming on California.

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[29] *Pike v. Bruce Church, Inc.* 397 U.S. 137, 142 (1970).
[30] Proposed Decision, pp. 75-6.
[31] *See* LAWDP opening comments filed August 6, 2007 at 46-47.

XI. CONCLUSION

The LADWP appreciates the opportunity to provide these opening comments to the CPUC and CEC for your consideration.

Dated: February 28, 2008 Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the attached:

OPENING COMMENTS OF THE
LOS ANGELES DEPARTMENT OF WATER AND POWER
ON THE PROPOSED DECISION OF PRESIDENT PEEVEY:
INTERIM OPINION ON GREENHOUSE GAS REGULATORY STRATEGIES

on all known parties to R.06-04-009 by transmitting an e-mail message with the document attached to each party named in the official service list, updated February 22, 2008. See attached service list. I served a copy of the document on those without e-mail addresses by mailing the document by first-class mail addressed as follows:

See attached service list.

I also caused courtesy copies to be delivered as follows:

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Executed this 28th day of February 2008, at Los Angeles, California.

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